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Stop the Stay: Interrupting Bankruptcy to Conduct Arbitration - Slipped Disc, Inc. v. CD Warehouse, Inc.

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NOTES

Stop the Stay: Interrupting Bankruptcy to Conduct Arbitration

*Slipped Disc, Inc. v. CD Warehouse, Inc.*¹

I. INTRODUCTION

Since its inception, arbitration has affected other practice areas of the law differently. Some practice areas, such as bankruptcy, have created special exceptions to accommodate the growth of arbitration. Arbitration's effect on the automatic stay in bankruptcy is explored in the following Note.

II. FACTS AND HOLDING

The plaintiff/debtor, Slipped Disc, Inc. ("Slipped Disc"), entered into a franchise agreement with CDX Audio Development, Inc. ("CDX"), to operate a retail compact disc store called CD Exchange.² CD Exchange later changed its name to Disc Go Round.³ CD Warehouse, the defendant, eventually purchased all the Disc Go Round franchises from CDX including the franchise owned by Slipped Disc.⁴

Under Slipped Disc's original franchise agreement with CDX, Slipped Disc enjoyed exclusive franchise rights within a certain geographic territory.⁵ An arbitration clause was also included in the contract between CDX and Slipped Disc.⁶ The arbitration provision provided that any controversy arising out of or relating to the franchise agreement would be resolved through arbitration and this would be the only procedure for resolving disputes.⁷

After CD Warehouse obtained the franchises from CDX, it granted a new franchise to Music Broker, Ltd. ("Music Broker"). Music Broker operated its franchise within Slipped Disc's exclusive franchise territory thereby violating the terms of Slipped Disc's original agreement with CDX.⁸ Slipped Disc sued CD Warehouse for breach of contract and simultaneously filed for bankruptcy.⁹

1. 245 B.R. 342 (Bankr. N.D. Iowa 2000).

2. *Id.* at 344.

3. *Id.*

4. *Id.*

5. *Id.*

6. *Id.*

7. *Id.*

8. *Id.*

9. *Id.*

On February 9, 2000, CD Warehouse filed a motion to stay Slipped Disc's bankruptcy proceeding and compel arbitration for the breach of contract claim.¹⁰ Slipped Disc argued the contract claim was a core proceeding under the Bankruptcy Code¹¹ and should be heard by the Bankruptcy Court.¹² CD Warehouse argued the strong federal policy favoring arbitration did not conflict with policies of the Bankruptcy Code and the arbitration provision should be enforced.¹³

The United States Bankruptcy Court for the Northern District of Iowa held the automatic stay should be lifted and the arbitration agreement should be enforced because: (1) the dispute between Slipped Disc and CD Warehouse did not implicate substantive bankruptcy rights; (2) the matter could be competently handled by an arbitrator; and (3) enforcing the arbitration clause would not undermine the policies of the Bankruptcy Code.¹⁴

III. LEGAL BACKGROUND

A. The Traditional Bankruptcy Proceeding

1. The Automatic Stay

When a debtor files for bankruptcy, an estate is created and it includes the debtor's legal and equitable interests in property as of the date of the bankruptcy petition.¹⁵ The property of the estate is the pool of assets from which the creditors will be paid after the bankruptcy case is finished.¹⁶ The automatic stay also begins when the bankruptcy petition is filed.¹⁷ Section 362 of the Bankruptcy Code provides for the automatic stay and its purpose is to prevent creditors from trying to collect on the debtor's obligation.¹⁸ By halting collection efforts, the automatic stay protects debtors because it gives them time and 'breathing room' to reorganize their finances.¹⁹ The automatic stay also protects creditors because it prevents other creditors from collecting on the property included in the bankruptcy estate.²⁰

The scope of the automatic stay is very broad and the exceptions listed in section 362 should be interpreted narrowly.²¹ Some of the exceptions to the automatic stay include criminal proceedings, actions to establish paternity, and proceedings to

10. *Id.* at 343

11. 11 U.S.C. § 101-1330 (1994).

12. *In re Slipped Disc*, 245 B.R. at 343.

13. *Id.* at 344.

14. *Id.* at 346.

15. 11 U.S.C. § 541; George M. Treister et al., *Fundamentals of Bankruptcy Law* 207 (3d ed., ALI 1993).

16. *Id.*

17. *In re Rollins*, 200 B.R. 427, 434 (Bankr. N.D. Ga. 1996).

18. 11 U.S.C. § 362.

19. Mark A. Shaiken & Cindi S. Woolery, *Automatic Stay Litigation in Bankruptcy* 9 (Wiley, John & Sons, Inc. 1995).

20. *Id.*

21. *Id.*

modify or establish child support or maintenance.²² The exceptions to the automatic stay are designed to promote public policy.²³

While there are many exceptions to the automatic stay provisions, courts have held the automatic stay does apply to arbitration proceedings.²⁴ The legislative history for the automatic stay provision specifically indicates that it should apply to arbitration proceedings by stating “[a]ll proceedings are stayed, including arbitration.”²⁵ Even though the automatic stay applies to arbitration, the Federal Rules of Bankruptcy Procedure allow a judge to submit a matter affecting the estate to arbitration.²⁶

Any party trying to collect against the debtor must petition the bankruptcy court to lift the automatic stay and allow its case to proceed against the debtor.²⁷ Under section 362(d) of the Bankruptcy Code, the bankruptcy judge may lift the stay for cause.²⁸ The party requesting relief from the stay has the burden of proof regarding the debtor’s equity interest and providing cause for lifting the stay; the debtor or any other party opposing lifting the automatic stay has the burden of proof on all other issues.²⁹ Because the automatic stay specifically applies to arbitration proceedings, the non-bankrupt party should seek relief from the stay before trying to enforce an arbitration provision against the debtor.³⁰ If the non-bankrupt party does not seek relief from the automatic stay and continues against the bankrupt debtor, he or she may be subject to sanctions by the bankruptcy court that can potentially include punitive damages.³¹

2. Core and Non-Core Proceedings

Another factor courts consider in deciding whether to allow an arbitration to continue is if the issue in the arbitration is a core proceeding under the Bankruptcy Code.³² Issues that arise under the Bankruptcy Code and affect the bankruptcy case will be considered core proceedings.³³ The Code lists numerous issues that are deemed to be core proceedings and some examples include confirmation of bankruptcy plans, matters concerning the administration of the estate, and determinations as to the dischargeability of the debts.³⁴ While the statute lays out an extensive list of what are core issues, the list is not exclusive and explicitly begins

22. 11 U.S.C. § 362(b).

23. See Shaiken & Wooleer, *supra* n. 19, at 10.

24. See *id.* at 29 (citing *In re Drexel Burnham Lambert Group, Inc.*, 160 B.R. 508, 511 (Bankr. S.D.N.Y. 1993)); *In re Charles P. Young Co.*, 111 B.R. 410, 417 (Bankr. S.D.N.Y. 1990)).

25. See Shaiken & Wooleer, *supra* n. 19, at 29 (citing H.R. Rpt. 95-595, at 340 (1977)(reprinted in 1978 U.S.C.C.A.N. 5963, 6297).

26. Fed. R. of Bankr. P. 9019 (2001)

27. 11 U.S.C. § 362(c).

28. 11 U.S.C. § 362(d).

29. 11 U.S.C. §§ 362(g)(1) - (2).

30. See Shaiken & Wooleer, *supra* n. 19, at 10.

31. 11 U.S.C. §362(h).

32. See *In re Slipped Disc*, 245 B.R. at 345.

33. 28 U.S.C. § 157(b)(1) (1994).

34. *Id.* § 157(b)(2).

with the statement, “[c]ore proceedings include, but are not limited to”³⁵ In addition to the statutory language, courts have held ‘core proceeding’ should be generously construed and the definition encompasses any litigation that a bankruptcy judge may decide.³⁶ Generally stated, any issue that involves the debtor’s bankruptcy case or rights established by the Bankruptcy Code can be considered core proceedings.³⁷ Under section 157, the bankruptcy courts have exclusive jurisdiction to determine the outcome of core proceedings.³⁸

The Bankruptcy Code does not clearly define a non-core proceeding.³⁹ The Code states, “a proceeding that is not a core proceeding but that is otherwise related to a case under [the Bankruptcy Code].”⁴⁰ Thus, the Code broadly defines a non-core proceeding because it can include any proceeding related to a bankruptcy case.⁴¹

The distinction between core and non-core proceedings is ultimately not important because the Code states, “[a] bankruptcy judge may hear a proceeding that is not a core proceeding but that is otherwise related to a case under the Code.”⁴² Under this language, even if the bankruptcy judge determines that a proceeding is not a core issue, he or she may maintain jurisdiction over the proceeding as long as it relates to the case filed under the Bankruptcy Code.⁴³ Thus, a bankruptcy court has broad discretion in determining what is a core proceeding and in deciding whether it will maintain jurisdiction over the proceeding.⁴⁴

The effect of the core and non-core distinction in the arbitration context is that a bankruptcy judge has exclusive jurisdiction over the issue if it is a core proceeding.⁴⁵ However, if an issue is a non-core proceeding, then the bankruptcy judge has discretion to hear the case or refer it to another appropriate forum.⁴⁶

The rules concerning core proceedings create a two-step process for initiating arbitration against a bankrupt party.⁴⁷ First, the bankruptcy judge must determine the issue is a non-core proceeding and it would be appropriate for another forum to hear the case.⁴⁸ Second, the bankruptcy judge must determine it is appropriate to lift the automatic stay in order to allow the non-core proceeding to go forward in the other forum.⁴⁹

35. *Id.*

36. *In re Arnold Print Works, Inc.*, 815 F.2d 165, 169 (1st Cir. 1987).

37. *See* Shaiken & Wooler, *supra* n. 19, at 51.

38. 28 U.S.C. § 157.

39. *See* Shaiken & Wooler, *supra* n. 19, at 57.

40. *See id.* at 57 (citing 28 U.S.C. § 157(c)(1)).

41. *See* Shaiken & Wooler, *supra* n. 19, at 57.

42. 28 U.S.C. § 157(c)(1).

43. *Id.*

44. *Id.*

45. *Id.* § 157(a)-(b)(1).

46. *Id.* § 157(c)(1).

47. *See* 28 U.S.C. § 157; 11 U.S.C. § 362.

48. 28 U.S.C. § 157.

49. 11 U.S.C. § 362.

3. Arbitration and Its Effect on Identifying a Claim as a Core Proceeding

While the definition of a core proceeding under section 157 is broad, courts have held a different standard should apply to arbitration cases.⁵⁰ The case *In re Gurga* established the standard for determining if an arbitration proceeding should be classified as a core issue.⁵¹ The Bankruptcy Appellate Panel for the Ninth Circuit Court of Appeals held that even if an issue is traditionally a core proceeding, arbitration should be allowed to continue if the issue does not implicate the right to bankruptcy, the right to a discharge, or some other substantive right created in the Bankruptcy Code.⁵² However, if the issue to be arbitrated deals exclusively with bankruptcy, then it is considered a core proceeding and the bankruptcy judge must maintain jurisdiction over the issue.⁵³

The Eighth Circuit Court of Appeals adopted a similar standard in *Specialty Mills, Inc. v. Citizens State Bank*.⁵⁴ In this case, the court held a core proceeding is one that arises only in bankruptcy or involves a right created by federal bankruptcy law while a non-core proceeding is one that could exist outside bankruptcy even though it may be related to the bankruptcy case.⁵⁵ Other courts have also held that the arbitration should be treated as a non-core proceeding and allowed to continue unless it implicates some area of bankruptcy law.⁵⁶ These courts narrowed the definition of a core proceeding and held an issue to be arbitrated is not a core proceeding unless it implicates bankruptcy law.

However, other courts have maintained the broad guidelines for what is a core proceeding and hold the bankruptcy court should not give up its jurisdiction except in very limited circumstances.⁵⁷ One such case is *In re Brookhaven Textiles, Inc.*, which held the bankruptcy court could decide a breach of contract issue because it was a core proceeding even though the contract contained an arbitration clause.⁵⁸ The court stated it had authority to decide the breach of contract issue because it: (1) did not involve a dispute that required special expertise of an arbitrator, and (2) the outcome of the case would affect the estate's assets.⁵⁹ Even though the arbitration did not implicate bankruptcy law, the court determined the breach of contract case was a core proceeding under the Bankruptcy Code.⁶⁰ This narrow definition of a core proceeding has been followed in other cases.⁶¹

50. *In re Slipped Disc*, 245 B.R. at 345.

51. 176 B.R. 196 (9th Cir. BAP 1994).

52. *Id.* at 199.

53. *In re Guild Music Corp.*, 100 B.R. 624, 628 (Bankr. D.R.I. 1989).

54. 51 F.3d 770 (8th Cir. 1995).

55. *Id.* at 773.

56. *See In re Pisgah Contractors, Inc.*, 215 B.R. 679, 684 (Bankr. W.D.N.C. 1995).

57. *In re Brookhaven Textiles, Inc.*, 21 B.R. 204, 206-07 (Bankr. N.Y. 1982).

58. *Id.* at 207.

59. *Id.*

60. *Id.* at 207-08.

61. *See In re Cross Electric*, 9 B.R. 408, 412 (Bankr. W.D. Va. 1981); *In re Braniff Airways*, 33 B.R. 33, 34-5 (Bankr. N.D. Tex. 1983).

4. Breach of Contract Claims as Core Proceedings

The following discussion will consider when a breach of contract claim is considered a core proceeding under the Bankruptcy Code. However, this discussion only relates to the fact scenario in *Slipped Disc*. Thus, the following analysis only relates to breach of contract actions that are initiated by a bankrupt debtor and the defendant files no proof of claim or counterclaim against the debtor. This fact situation is parallel to *Slipped Disc* and I have chosen a narrow consideration of this topic due to the amount of information available.⁶²

Almost every circuit has held a breach of contract action initiated by the debtor against a defendant that does not file a proof of claim or a counterclaim is not a core proceeding under the Bankruptcy Code.⁶³ One particular case, *In re Nationwide Roofing & Sheet Metal, Inc.*, outlined specific factors for determining what is a non-core proceeding.⁶⁴ In this case, the court held that non-core proceedings include: (1) matters not specifically listed in section 157(b)(2) of the Bankruptcy Code; (2) matters that existed prior to the filing of the petition; (3) matters that would continue to exist independent of the Bankruptcy Code; and (4) matters in which the rights of the parties were not significantly affected by the filing of the bankruptcy case.⁶⁵

Under the *Nationwide Roofing* standard, most breach of contract claims will probably be non-core proceedings.⁶⁶ However, the first factor of the *Nationwide Roofing* test is in conflict with the actual language of the Code which states, “[c]ore proceedings include, but are not limited to . . .”⁶⁷ Even though the Code explicitly says the list in section 157(b)(2) is not exclusive, the first element in the *Nationwide Roofing* test indicates a different interpretation.⁶⁸ While the law is almost uniform on this particular issue, it has experienced drastic changes during the last twenty years.⁶⁹

62. For a more thorough discussion on when a breach of contract claim is a core proceeding under the Bankruptcy Code, see Andrew M. Campbell, *Action for Breach of Contract as Core Proceeding in Bankruptcy Under 28 U.S.C. § 157(b)*, 123 A.L.R. Fed. 103 (1995)

63. *See id.*

64. 130 B.R. 768 (Bankr. S.D. Ohio 1991).

65. *Id.* at 775.

66. *Id.* at 776.

67. 28 U.S.C. § 157(b)(2).

68. *Nationwide Roofing*, 130 B.R. at 775.

69. For a discussion of outdated case law that held breach of contract actions initiated by the debtor against a defendant that does not file a proof of claim or counterclaim to be a core proceeding, see Campbell, *supra* n. 63.

B. Arbitration and the Automatic Stay

1. Cases Allowing Arbitration to Proceed Despite the Automatic Stay

Courts consistently allow arbitrations to go forward in the bankruptcy context. One case is *In re Guy Long, Inc.*⁷⁰ Like *Slipped Disc*, *Guy Long* involves a debtor suing a noncreditor over a breach of contract claim.⁷¹ In response, the noncreditor defendant moved to lift the automatic stay and enforce the contract's arbitration clause.⁷² The debtor claimed arbitration would be unjust and, like *Slipped Disc*, it tried to assert the conflicting policies of the Federal Arbitration Act ("FAA") and the Bankruptcy Code as justification for not allowing the arbitration.⁷³

The Pennsylvania Court of Appeals rejected the debtor's arguments and allowed the arbitration to proceed.⁷⁴ In doing so, the court outlined four reasons for permitting the arbitration: (1) the arbitration would not jeopardize the debtor's ability to formulate a bankruptcy plan or weaken the debtor's financial situation; (2) the dispute did not implicate bankruptcy issues; (3) the breach of contract litigation was initiated by the debtor against the noncreditor; and (4) the dispute would be solved more quickly in arbitration.⁷⁵ The court further held the conflicting policies of the FAA and the Bankruptcy Code are not important concerns when these four elements are satisfied.⁷⁶

Another case that involved a breach of contract claim was *In re Bailey*.⁷⁷ The debtor entered into an agreement with his employer that allowed for the arbitration of any disputes in Utah.⁷⁸ The debtor moved to Texas to take care of his mother and, after filing for bankruptcy, filed an adversary proceeding against his former employer for breach of contract.⁷⁹ The defendant moved to lift the automatic stay enforce the contract's arbitration clause.⁸⁰

The Texas court granted the defendant's motion and ordered the arbitration to proceed in Utah.⁸¹ The court held that enforcing the prepetition arbitration agreement would not conflict with the policies of the Bankruptcy Code and, as a result, the court must allow the arbitration to proceed.⁸² Furthermore, the court held the arbitration must go forward in Utah (the agreed upon forum), "where employee failed to present any additional evidence of his financial inability to pursue action through arbitration in Utah or that enforcement of forum selection clause would

70. 90 B.R. 99 (Pa. Ct. App. 1988).

71. *Id.*

72. *Id.*

73. *Id.*

74. *Id.*

75. *Id.* at 102.

76. *Id.*

77. 217 B.R. 523 (Bankr. E.D. Tex. 1997).

78. *Id.* at 524.

79. *Id.* at 525.

80. *Id.*

81. *Id.* at 526.

82. *Id.* at 527.

preclude employee from fulfilling any family obligations.⁸³ Therefore, the court allowed the arbitration to proceed and enforced the exact terms of the arbitration agreement.⁸⁴

Another case that allowed arbitration to proceed was *In re Pate*.⁸⁵ In *Pate*, the debtor filed an adversary proceeding against a mobile home dealership claiming the sale of the mobile home violated the Federal Truth in Lending Act.⁸⁶ The defendant/creditor filed a motion to stay the bankruptcy proceeding and enforce the arbitration clause in the sales contract.⁸⁷

Ruling on the defendant's motion, the court held the arbitration clause should be enforced between the parties.⁸⁸ Like *Guy Long*, the court used a case-by-case analysis and determined that arbitration would be appropriate under these circumstances because allowing the arbitration would not undermine the goals of the Bankruptcy Code and it would not adversely affect the administration of the estate.⁸⁹

The Bankruptcy Court of Minnesota took a novel approach in allowing arbitration to proceed in *In re Smith Jones, Inc.*⁹⁰ In this case, the debtor corporation filed for bankruptcy protection and, in response, the labor unions sought to lift the automatic stay so they could prosecute their grievances against the corporation.⁹¹

Citing the preferential status given to arbitration provisions in collective bargaining agreements, the court allowed the arbitration to continue.⁹² In addition, the court expressly reserved its jurisdiction to review any monetary award from the arbitration proceeding.⁹³ Citing its broad jurisdiction under the Bankruptcy Code, the court held the arbitration award would affect the bankruptcy estate and the court should retain jurisdiction to review the arbitration award.⁹⁴

While all of these cases provide insight into when a court will enforce an arbitration agreement involving a bankrupt party, one of the most important cases is *In re Gurga*.⁹⁵ In *Gurga*, the debtor operated a "1-900" phone service and entered into a contract with MCI to provide for billing procedures.⁹⁶ *Gurga* filed for bankruptcy and brought an adversary action against MCI for breach of contract.⁹⁷ The defendant, MCI, responded by moving to lift the automatic stay to enforce the contract's arbitration provision.⁹⁸

The Bankruptcy Appellate Panel (BAP) for the Ninth Circuit Court of Appeals held the debtor had agreed to exclusive, mandatory arbitration of any contract

83. *Id.*

84. *Id.*

85. 198 B.R. 841 (Bankr. S.D. Ga. 1996).

86. *Id.* at 842.

87. *Id.* at 843.

88. *Id.* at 847.

89. *Id.*

90. 17 B.R. 126 (Bankr. Minn. 1981). See *In re Gurga*, 176 B.R. 196.

91. See *In re Smith Jones*, 17 B.R. at 126.

92. *Id.* at 127 (citing *United Steelworkers v. Am. Mfg Co.*, 363 U.S. 564 (1960)).

93. *Id.* at 128.

94. *Id.*

95. *In re Gurga*, 176 B.R. 196.

96. *Id.* at 198.

97. *Id.*

98. *Id.*

dispute.⁹⁹ The BAP also held the breach of contract claim was a non-core proceeding and, because it was non-core, the bankruptcy court had no discretion in whether to refer the matter to arbitration.¹⁰⁰ The BAP then held that when an issue is a non-core proceeding, a bankruptcy court must refer the matter to arbitration upon motion of the parties.¹⁰¹

Another important case from the Ninth Circuit BAP is *In re Morgan*.¹⁰² Like *Gurga, Morgan* requires a bankruptcy court to refer a matter to arbitration in certain proceedings.¹⁰³ In this case, the BAP held a debtor is bound by the mandatory arbitration provisions in a contract when the debtor initiates an adversary proceeding based on that same contract and the decision regarding arbitration is mandatory.¹⁰⁴ Thus, like *Gurga, Morgan* removes the discretionary options normally afforded to bankruptcy courts and, in these limited fact scenarios, requires the judge refer the matter to arbitration pursuant to a motion by one of the parties.¹⁰⁵

2. Cases Denying Arbitration and Upholding the Automatic Stay

While there are numerous cases allowing arbitration proceedings to continue, there are just as many that deny motions to lift the automatic stay. One such case is *In re U.S. Lines, Inc.*¹⁰⁶ In this case, the debtor was a shipping company that filed for bankruptcy protection.¹⁰⁷ The reorganization trust sought a declaration of coverage under debtor's pre-petition contracts for protection and indemnity insurance.¹⁰⁸

The court refused to refer the matter to arbitration citing a number of factors.¹⁰⁹ The court classified the case as a core proceeding and stated the bankruptcy court must maintain jurisdiction to preserve the trust assets and ensure an equitable payout to the other creditors.¹¹⁰ The court also stated the bankruptcy court was the preferable venue to handle mass tort actions against the debtor and the complex factual scenario augmented the need to have a centralized handling of the case.¹¹¹ Thus, the court cited the need for efficiency and the issue's status as a core proceeding as reasons for maintaining the automatic stay and denying arbitration.¹¹²

99. *Id.* at 200.

100. *Id.*

101. *Id.*

102. 28 B.R. 3 (B.A.P. 9th 1983).

103. *Id.* at 5.

104. *Id.*

105. *Gurga*, 176 B.R. at 200.

106. 197 F.3d 631 (2d Cir. 1999).

107. *Id.* at 635.

108. *Id.*

109. *Id.*

110. *Id.* at 636.

111. *Id.*

112. *Id.*

Another case that refused to enforce an arbitration provision was *In re Braniff Airways*.¹¹³ In this case, the creditors of the estate were other airlines.¹¹⁴ The creditor airlines moved to have the bankruptcy proceedings stayed so arbitration on certain matters could proceed pursuant to the parties' contract.¹¹⁵

The court denied the motion for arbitration citing numerous factors.¹¹⁶ One factor the court cited was the conflicting policies between the Bankruptcy Code and the FAA.¹¹⁷ It noted the automatic stay provision specifically applied to arbitrations and was meant to expedite and facilitate a smooth bankruptcy case.¹¹⁸ The court stated this policy of the Bankruptcy Code, in conjunction with the need to protect creditors, overrides the policies of the FAA.¹¹⁹ As a result, the court declined to allow arbitration to proceed in this case.¹²⁰

Another dispute that was not referred to arbitration was *In re Brookhaven Textiles, Inc.*¹²¹ In this case, the debtor filed an adversary proceeding in order to enforce a contract with the defendant.¹²² The contract did contain an arbitration provision, but the court still refused to submit the matter to an arbitrator.¹²³

In refusing to enforce the arbitration provision, the court held it was a matter of discretion when a bankruptcy court should surrender its jurisdiction to an arbitration forum.¹²⁴ The court also held the breach of contract claim was well within the expertise of the court and did not require the special skills of an arbitrator.¹²⁵ The court also cited the effect the dispute's outcome would have on the assets of the estate.¹²⁶ Because the dispute would undoubtedly affect the rights of the unsecured creditors, the court determined it should retain jurisdiction over the matter.¹²⁷ Thus, the court held enforcing the arbitration clause was not appropriate because the matter did not require special expertise and the dispute would affect the estate's assets.¹²⁸

Another important case that refused to enforce the arbitration clause was *In re Charles P. Young Co.*¹²⁹ In this case, the employer filed for bankruptcy and requested the bankruptcy court relieve the employer from being subject to arbitration provisions of a collective bargaining agreement with the employees' union.¹³⁰

The court cited four factors to determine if the automatic stay should be lifted and if arbitration should proceed.¹³¹ The four factors the court included: (1) whether

113. 33 B.R. 33.

114. *Id.*

115. *Id.*

116. *Id.*

117. *Id.* at 34.

118. *Id.* at 34-5.

119. *Id.*

120. *Id.*

121. 21 B.R. 204 (Bankr. S.D.N.Y. 1982).

122. *Id.* at 205.

123. *Id.*

124. *Id.* at 206-7.

125. *Id.* at 207.

126. *Id.*

127. *Id.*

128. *Id.* at 206-7.

129. 111 B.R. 410.

130. *Id.* at 411.

131. *Id.* at 417.

the issue can be resolved more expeditiously by the bankruptcy judge as opposed to through the arbitration process; (2) whether special expertise is necessary in deciding the issue; (3) the impact on creditors of the debtor who were never parties to the agreement containing the arbitration clause; and (4) whether arbitration threatens the assets of the estate.¹³² In weighing these factors, the court determined arbitration would not be the proper venue for the union grievances and the bankruptcy court should retain jurisdiction.¹³³ This case is particularly important because it serves as the foundation for the holding in *Slipped Disc*.¹³⁴

While the previous four cases are just a few examples of bankruptcy courts denying arbitration, they are indicative of the varying approaches courts take toward enforcing arbitration agreements in a bankruptcy context.

3. Judicial Discretion in Determining Whether to Allow Arbitration

In addition to the dizzying array of case law about when a bankruptcy court will allow an arbitration to proceed, there is also disagreement about when the decision is discretionary. United States District Courts in the Second, Fourth, Sixth, and Eighth Circuits have held the decision of whether to enforce a contract's arbitration clause is within the sole discretion of the bankruptcy judge.¹³⁵

The Bankruptcy Court for the Western District Court of Virginia held the decision of whether to refer a matter to arbitration is a discretionary function of the bankruptcy judge.¹³⁶ In *Sterling Mining*, the district court recognized the bankruptcy court's authority to hear issues regarding civil remedies and this authority extends to arbitration.¹³⁷ The court noted that even though the bankruptcy court has this power, it could refrain from exercising it and could decline to hear a case in the interest of justice.¹³⁸

Like the District Court of Virginia, the Fifth Circuit Court of Appeals held in *The Matter of National Gypsum*¹³⁹ that referring a matter to arbitration is a discretionary decision of the bankruptcy judge. In this case, the Fifth Circuit held discretion is not governed solely by whether a proceeding is a core or non-core matter.¹⁴⁰ The court stated a judge should consider whether the issue derives exclusively from the Bankruptcy Code and, if so, whether the arbitration would conflict with the policies of the Code.¹⁴¹

132. *Id.*

133. *Id.* at 418.

134. *In re Slipped Disc*, 245 B.R. 342.

135. See *In re Brookhaven Textiles*, 21 B.R. 204; *In re Sterling Mining Co.*, 21 B.R. 66 (Bankr. W.D. Va. 1982); *In re Cross Electric Co.*, 9 B.R. 408; *Hupp Indus. v. Envtl. Prods. Amalgamated Pty.*, 157 B.R. 360; *In re Hart Ski Mfg. Co.*, 711 F.2d 845 (8th Cir. 1983).

136. *In re Sterling Mining*, 21 B.R. 66.

137. *Id.* at 68.

138. *Id.*

139. 118 F.3d 1056 (5th Cir. 1997).

140. *Id.* at 1067.

141. *Id.*

IV. INSTANT DECISION

The United States Bankruptcy Court for the Northern District of Iowa held the automatic stay should be lifted and the arbitration agreement should be enforced because: (1) the dispute between Slipped Disc and CD Warehouse did not implicate substantive bankruptcy rights; (2) the matter could be competently handled by an arbitrator; and (3) enforcing the arbitration clause would not undermine the policies of the Bankruptcy Code.¹⁴²

*A. Competing Policies of the Bankruptcy Code
and the FAA*

First, the court considered the competing policies of the Bankruptcy Code and the FAA.¹⁴³ The court noted the FAA states that arbitration agreements shall be valid and enforceable and, upon motion by one of the parties, a trial of an action shall be stayed in order to allow the arbitration agreement to be enforced.¹⁴⁴ The bankruptcy court noted the Supreme Court recognized an exception to this rule when the arbitration would undermine the policies of another federal statute, such as the Bankruptcy Code.¹⁴⁵

One policy of the Bankruptcy Code that conflicts with the FAA is the policy favoring resolution of bankruptcy issues in a single forum.¹⁴⁶ The Iowa court stated that to allow litigation to proliferate in other forums would undermine the Code's policy favoring consolidation of bankruptcy issues into one forum.¹⁴⁷ Another bankruptcy policy that conflicts with arbitration is maintaining the assets of the estate for creditors.¹⁴⁸ The court was concerned arbitration costs would reduce the available assets for creditors and cause injustice to them.¹⁴⁹ The Iowa court then stated when conflicts like these arise, the court must weigh the competing policies to determine if arbitration will undermine the Bankruptcy Code's policies.¹⁵⁰ If allowing arbitration will not undermine the Code's policies, then the arbitration clause should be enforced.¹⁵¹

In this case, the Iowa court held that to allow arbitration to proceed would not undermine the policies of the Bankruptcy Code because the breach of contract issue was not a core proceeding that implicated bankruptcy issues and the arbitration would not threaten the assets of the estate.¹⁵²

142. *In re Slipped Disc*, 245 B.R. at 346.

143. *Id.* at 344.

144. *Id.* (citing 9 U.S.C. §§ 2-3).

145. *Id.* (citing *Shearson / Am. Exp. v. McMahon*, 482 U.S. 220, 226-27 (1987)).

146. *Id.* (citing *In re Trident Shipworks, Inc.*, 243 B.R. 130, 132 (Bankr. M.D. Fla. 1999)).

147. *Id.*

148. *Id.* (citing *In re Knepp*, 229 B.R. 821, 844-45 (Bankr. N.D. Ala. 1999)).

149. *Id.* (citing *In re Knepp*, 229 B.R. at 843, 845).

150. *Id.* (citing *Hays & Co.*, 885 F.2d at 1161).

151. *Id.*

152. *In re Slipped Disc*, 245 B.R. at 346.

B. Distinguishing Core and Non-Core Proceedings

The court began by stating that enforcing arbitration clauses for non-core proceedings was appropriate.¹⁵³ The court also stated that since the issue in *Slipped Disc* was a counterclaim by the estate against one of its creditors, then it technically was a core proceeding under the Bankruptcy Code's definition.¹⁵⁴ However, the court found that when the issue to be decided does not implicate substantive bankruptcy rights, the issue should be considered non-core and referred to arbitration even though it was technically a core proceeding under the Code's definition.¹⁵⁵ Under this analysis, the court held that since the breach of contract claim did not implicate substantive bankruptcy rights, the arbitration clause should be enforced even though the issue was a core proceeding.¹⁵⁶

C. Court's Discretion to Compel Arbitration

The court noted the judge's ultimate decision about whether to allow arbitration is discretionary because of the conflicting policies of the FAA and the Bankruptcy Code.¹⁵⁷ In exercising this discretion, the court stated the judge should consider four factors: (1) whether the issue can be resolved more expeditiously by the bankruptcy judge as opposed to the arbitration process; (2) whether special expertise is necessary in deciding the issue; (3) the impact on creditors of the debtor who were never parties to the agreement containing the arbitration provision; and (4) whether arbitration threatens the estate assets.¹⁵⁸ The court stated a bifurcation of the proceedings between arbitration and the bankruptcy court may not be efficient, but the efficiency argument does not outweigh the strong presumption in favor of arbitration.¹⁵⁹

In considering these factors, the court notes the party opposing the arbitration bears the burden of proof.¹⁶⁰ The court stated *Slipped Disc* (the party opposing the arbitration) has not addressed these factors and, as a result, there is no compelling reason to deny arbitration.¹⁶¹ *Slipped Disc* argued the proceeding was a core issue and should be decided exclusively by the bankruptcy court, not through arbitration.¹⁶² However, the court held the breach of contract claim was not a core proceeding since arbitration would not implicate substantive bankruptcy rights.¹⁶³

153. *Id.* at 345 (citing *In re Pisgah Contractors*, 215 B.R. at 684).

154. *Id.* (referring to 28 U.S.C. § 157(b)(2)(c)).

155. *Id.* (citing *In re Gurga*, 176 B.R. at 196, 199).

156. *Id.*

157. *Id.* at 344 (citing *In re Knepp*, 229 B.R. at 845).

158. *Id.* at 346 (citing *In re Charles P. Young Co.*, 111 B.R. at 417).

159. *Id.* at 346.

160. *Id.* (citing 11 U.S.C. § 362(g)).

161. *Id.*

162. *Id.*

163. *Id.*

Slipped Disc also argued that enforcing the arbitration clause would deny fairness to the debtors.¹⁶⁴ The court responded to this assertion by pointing out that not enforcing the arbitration clause was just as unfair to the defendant and the court would be unilaterally changing the terms of a private contract if it did not enforce the arbitration provisions.¹⁶⁵ The court also noted the Eighth Circuit rejected fairness arguments when determining the enforceability of arbitration clauses.¹⁶⁶ Therefore, since Slipped Disc did not satisfy its burden of proof related to the four factors, the court held the arbitration should proceed and the automatic stay in the bankruptcy court should be lifted.¹⁶⁷

V. COMMENT

A. *The Legal Issues*

There are three general approaches concerning whether to enforce arbitration agreements involving a bankrupt debtor.¹⁶⁸ The first approach is arbitration should automatically be considered a non-core proceeding unless the arbitration will implicate substantive bankruptcy issues or rights.¹⁶⁹

The second approach is to use a varying list of four factors and, based on these factors, determine whether arbitration would be appropriate.¹⁷⁰ The factors vary among the cases with some considering which party instituted the suit¹⁷¹ and others considering the effect arbitration will have on the bankruptcy estate.¹⁷² While many courts use this factor-based analysis, there is still little agreement about which factors to consider.

The third approach for determining whether to allow arbitration to proceed is to cite the conflicting policies of the Bankruptcy Code and the FAA and to allow arbitration unless it would undermine the policies of the Bankruptcy Code.¹⁷³ Some of the Bankruptcy Code policies that may be infringed by an arbitration proceeding include having the case expeditiously handled, having all relevant issues determined by the same court, and protecting the assets of the estate.¹⁷⁴

164. *Id.*

165. *Id.*

166. *Id.* (citing *Matter of Hart Ski Mfg. Co., Inc.*, 22 B.R. 763, 765 (D. Minn. 1982), *aff'd.*, 711 F.2d 845 (8th Cir. 1983)).

167. *Id.*

168. *See supra* section II(B).

169. *See In re Gurga*, 176 B.R. at 200; *Specialty Mills v. Citizens State Bank*, 51 F.3d 770 (holding that arbitration is a non-core proceeding where it does not involve bankruptcy issues).

170. *See In re Guy Long, Inc.*, 90 B.R. 99; *In re Brookhaven Textiles, Inc.*, 21 B.R. 204; *In Re Charles P. Young*, 111 B.R. 410.

171. *In re Guy Long, Inc.*, 90 B.R. at 102 (holding that since the debtor initiated the breach of contract litigation, it should be bound by terms of the contract).

172. *In re Brookhaven Textiles*, 21 B.R. 204.

173. *See In re Bailey*, 217 B.R. 523; *In re Pate*, 198 B.R. 841; *In re Braniff Airways*, 33 B.R. 33 (holding that arbitration should be allowed to proceed unless allowing arbitration would undermine the policies of the Bankruptcy Code).

174. *Id.*

The jurisdiction of the bankruptcy proceeding will determine which test the court will apply. There is no uniformity about which approach to use or how to apply the tests within each approach.

The import of *Slipped Disc* is that it considered and incorporated the three tests outlined above and still allows arbitration to proceed.¹⁷⁵ The court considered and discussed the arbitrability of non-core proceedings, the four factor analysis, and the conflicting policies of the Bankruptcy Code and the FAA.¹⁷⁶ While *Slipped Disc* is not harrowing precedent or a groundbreaking decision, it is one of the few cases to consider all three tests in one consolidated matter. The importance of the case is that it cites these three tests and, after considering each test under the circumstances, the court enforces the arbitration agreement.

By allowing arbitration to proceed, the court was implicitly indicating that which specific test is used is not important. By weighing each test under the facts of the case and still allowing arbitration to proceed, the court was indicating that private arbitration agreements should take priority when it is possible. Furthermore, the court was demonstrating its belief that none of the tests are so overwhelming as to deny the enforcement of a private arbitration agreement. The court was sending a signal that arbitration should take precedence regardless of the test or standard being invoked unless the arbitration involves some sort of substantive bankruptcy issue. While *Slipped Disc* does not create law, it may be a guide for how future courts may address this issue.

B. The Policy Issues

While *Slipped Disc* is an important case, it does not have precedential value. Despite the court's ruling, there is still jurisdictional conflict over when to allow arbitration in a bankruptcy context.

First, there is a split over whether judges have discretion to allow arbitrations to go forward.¹⁷⁷ While a majority of jurisdictions hold that judges do have discretion, there are still cases holding that it is not a decision within the court's discretion.

Second, there is no conformity about what standard or test to apply when determining whether to allow arbitration to proceed.¹⁷⁸ This lack of uniformity in the bankruptcy - arbitration context complicates both practice areas and impedes attorneys from providing clear recommendations to their clients.

Third, there is no agreement about arbitration's effect on whether a proceeding is core or non-core under the Bankruptcy Code.¹⁷⁹ Some jurisdictions hold that arbitration automatically makes a proceeding non-core unless it involves substantive bankruptcy issues while other jurisdictions strictly follow the definitions of core and non-core found in the Bankruptcy Code.¹⁸⁰

175. *Id.*

176. *See supra* section III.

177. *See supra* section II(B)(3).

178. *See supra* sections II(B)(1) & (B)(2).

179. *See supra* section II(A)(3).

180. *Id.*

Finally, there are various holdings on when a breach of contract claim is a core or non-core proceeding.¹⁸¹ These holdings are very fact specific and the slightest change in circumstances can affect the determination of a breach of contract claim as a core or non-core proceeding.¹⁸²

Ultimately, the interplay between bankruptcy and arbitration is intricate and complex. It is an issue that is plagued with splits of authority and with conflicting holdings. Furthermore, it is an issue that involves conflicting federal law - the policy conflicts between the Bankruptcy Code and the FAA. The two legal paradigms that are affected by these conflicts are important to the general public and to the legal profession. Both bankruptcy and dispute resolution practitioners need to know how their particular areas are affected by the other and, because of this need, this is an area of the law where clarity is necessary. In order to find this clarity and provide solid answers to practitioners in both fields of law, appellate courts should resolve the enforceability of arbitration provisions in the bankruptcy context.

VI. CONCLUSION

In re Slipped Disc is a culmination of the law regarding bankruptcy and arbitration in that it utilizes most of the factors listed by other bankruptcy courts and considers these factors in their totality. While it is an important case, it is not authoritative. In order to resolve the conflicting authorities, an appellate consideration of these important issues should be granted.

MATTHEW DAMERON

181. See *supra* section II(A)(4).

182. See Campbell, *supra* n. 64.